

ST 03-0030-GIL 02/14/2003 CONSTRUCTION CONTRACTORS

This letter discusses the tax liability of construction contractors. See 86 Ill. Adm. Code 130.1940. (This is a GIL).

February 14, 2003

Dear Xxxxx:

This letter is in response to your letter dated November 15, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

I am writing on behalf of a taxpayer. We would like to determine if any of our process is subject to sales tax. Also, are we required to obtain a reseller certificate and/or any other exempt certificate?

The taxpayer transacts business in Illinois. It designs, develops and installs communication networks for Cable TV Operators, telecom companies, and Internet Service Providers. The services include broadband design engineering, premise wiring, systems integration, and installation of central office and head-end equipment, as well as development and installation of proprietary products to enhance wireless communications.

The taxpayer is a subcontractor for the local cable companies. It provides the materials to do the work, as well as building and maintenance of a cable plant. It is given the coaxial cable to install or replace in the cable system on telephone poles or underground.

In addition to the above services, one division of the company purchases network hardware and installs connection into buildings. Some of the installations include telephone systems.

One other division develops the concept of creating improved communication signals. It subcontracts out the design feature and the installation process. It purchases from vendors' products such as antennas, filters, amplifiers, receivers and transmitters. It sells its products or uses the products during the installation process.

These services are provided to state, local and federal authorities. They are also provided to education facilities.

Can you please let me know if any of the process is subject to sales tax? If we are required to collect the sales tax? If we are required to collect or provide reseller/exemption certificates?

Thank you for your anticipated response.

DEPARTMENT'S RESPONSE:

SALES AND USE TAXES

Based upon the descriptions of the varied types of businesses that your client engages in, we cannot give you specific answers since those answers will depend upon what type of sales or services your client is engaged in each specific instance. We have provided some general information below that may be helpful in advising your client.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See the enclosed copy of 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

Please be advised that Section 1 of the Retailers' Occupation Tax Act (35 ILCS 120/1) provides that construction contracts for the improvement of real estate consisting of engineering, installation, and maintenance of voice, data, video, security, and all telecommunications systems, do not constitute engaging in a business of selling tangible personal property at retail within the meaning of the Act if they are sold at one specified contract price. Rather, such contractors incur tax liability on their cost price of such systems. See the information provided in this letter regarding construction contracts and 86 Ill. Adm. Code 130.1940(c)(3).

SERVICE OCCUPATION TAX

In regards to the design, engineering, and development of products by your client, Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information we are enclosing copies of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service;

(2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See the enclosed copy of 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See the enclosed copy of 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See the enclosed copy of 86 Ill. Adm. Code 140.108.

Please be advised that firms who do repair work for customers of another business are sometimes secondary servicemen in multi-service situations. Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. See 86 Ill. Adm. Code 140.145 for information about multi-service situations and see 86 Ill. Adm. Code 140.141 for explanations of the tax consequences of warranty repair work. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301(a).

When both primary servicemen and secondary servicemen are registered, primary servicemen may give a Certificate of Resale to registered secondary servicemen for any tangible personal property purchased. See Section 140.145(c). Primary servicemen could then collect Service Use Tax from their customers based upon the separately stated selling price of the property or 50% of the bill to the service customers.

If primary servicemen are registered and de minimis, they may choose to remit Service Occupation Tax to the Department based upon their cost price of tangible personal property purchased from secondary servicemen. It shall be presumed that the cost price to the serviceman of the property transferred to him by his or her subcontractor is 50% of the total bill from the secondary serviceman in the absence of proof of the consideration paid by the subcontractor for the purchase of such property. Registered de minimis primary servicemen provide the secondary servicemen with Certificates of Resale if the secondary servicemen are registered, and collect Service Use Tax from customers on their cost price.

Please note that the Illinois General Assembly enacted legislation that provides for multi-service situations that involve unregistered de minimis servicemen. Public Act 89-675, effective August 14, 1996, states that if an unregistered de minimis serviceman subcontracts service work to an unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman. See Section 140.145(a). This certification option is only available in multi-service situations when both the primary and secondary servicemen are unregistered and de minimis, 35 ILCS 110/2 and 115/2.

CONSTRUCTION CONTRACTS

If a person or business is contractually required to purchase tangible personal property for incorporation into real estate, then it would be acting as a construction contractor. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property. See the enclosed copies of 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. Persons from other states who act as construction contractors in Illinois by permanently affixing tangible personal property to real estate owe Illinois Use Tax on the cost price of the tangible personal property affixed to that real estate.

The Illinois Use Tax Act provides, that in order to prevent multi-state taxation, the Use Tax does not apply to the use, in Illinois, of tangible personal property acquired outside of this State and caused to be brought into this State by a person who has already paid a tax in another state in respect to the sale, purchase, or use of such property, to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of the enclosed copy of 86 Ill. Adm. Code 150.310.

If subcontractors are utilized and are acting as construction contractors, the transaction between the general contractors and the subcontractors is not a taxable transaction. The subcontractors incur Use Tax liability on any tangible personal property that they purchase for incorporation into real estate. If, however, general contractors make purchases and then contract to have subcontractors do the installation, the general contractors incur Use Tax liability because they are making the purchases of such tangible personal property. Please note that any tangible personal property provided by the customer, such as the coaxial cable referenced in your letter, would not subject the construction contractor to use tax liability (the customer itself will incur the use tax liability on the purchase of that property).

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many

construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that this reimbursement cannot be billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

If an out-of-State contractor also makes retail ("over-the-counter") sales to Illinois customers without installation, that contractor may be required to register and collect Use Tax (6.25%) on those sales if the contractor has sufficient nexus under the Quill decision described below. Please note again that subcontractors in Illinois are generally considered representatives of general contractors for purposes of determining physical presence for tax purposes.

SALES TO EXEMPT ORGANIZATIONS

Organizations that make application to the Department of Revenue and are determined to be exclusively religious, educational or charitable organizations receive an exemption identification number (an "E-number") from the Department. See the enclosed copies of 86 Ill. Adm. Code 130.2005 and 130.2007. This number evidences that the Department recognizes the organizations as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of their organizational purposes. If an organization does not have an E-number, then its purchases are subject to tax. Please be aware that only sales to organizations holding the E-number are exempt, not sales to individual members of the organization. See subsection (k) of Section 130.2005. Sales to governmental bodies are also generally subject to tax unless the governmental body has obtained an active E-number from the Department. See the enclosed copy of 86 Ill. Adm. Code 130.2080.

As stated above, contractors are generally considered to be the end users of tangible personal property they permanently incorporate into real estate and owe Use Tax upon their purchases. However, contractors who physically incorporate tangible personal property into real estate owned by holders of E-numbers can purchase such property tax-free by providing their suppliers with the certification described in Section 130.2075(d), as well as the E-number of the group into whose real estate that property will be incorporated. See enclosed copy of 86 Ill. Adm. Code 130.2075. The suppliers should retain this information in order to document the tax-exempt sale.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.